

Office of the State Auditor
Division of State Audit

North Dakota Council on the Arts
Bismarck, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 709

Robert R. Peterson
State Auditor



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Transmittal Letter

June 30, 2008

The Honorable John Hoeven, Governor

Members of the North Dakota Legislative Assembly

Ms. Janine C. Webb, Executive Director, North Dakota Council on the Arts

We are pleased to submit this audit of the North Dakota Council on the Arts for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kristi Morlock. Kevin Scherbenske, CPA was the staff auditor. Fred Ehrhardt, CPA was the audit supervisor and Paul Welk, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit supervisor or audit manager by calling (701) 328-2320. We wish to express our appreciation to Ms. Janine Webb and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Council on the Arts (NDCA) is a state agency responsible for the support and development of the arts and artists throughout North Dakota. The Council functions as a community partner and catalyst for artists and organizations. It offers educational opportunities, technical advice, collects and disseminates arts information, and provides financial assistance in the form of grants to not-for-profit organizations.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the North Dakota Council on the Arts in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing "receipts reconciliation" (page 12), "review and approval of correcting entries" (page 12), and "reconciliation of federal revenue" (page 13), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

There were no recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 16 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The North Dakota Council on the Arts' financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the North Dakota Council on the Arts.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the North Dakota Council on the Arts for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Council on the Arts' operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Council on the Arts and are they in compliance with these laws?
3. Are there areas of the North Dakota Council on the Arts' operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the North Dakota Council on the Arts is for the biennium ended June 30, 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The North Dakota Council on the Arts' sole location is its central office which will be included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Nonstatistical sampling was used and the results were

projected to the population. Further where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) ERP system. Given the complexity of the state's accounting system significant evidence was obtained from ConnectND.
- Observed North Dakota Council on the Arts' processes and procedures.

In aggregate there were not any significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion and Analysis

The accompanying financial statements have been prepared to present the North Dakota Council on the Arts' revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2007, operations of the North Dakota Council on the Arts were primarily supported by federal funding from the National Endowment for the Arts (NEA) and appropriations from the state's general fund.

FINANCIAL SUMMARY

The North Dakota Council on the Arts had investments held at the State Investment Board during the 2005-2007 biennium. These investments totaled approximately \$266,723 at June 30, 2007. The investments were from the North Dakota Cultural Endowment fund as set up in NDCC sections 54-54-08.1 and 54-54-08.2.

Revenues consisted primarily of federal funds. Other revenues during the audited period included miscellaneous general revenue. These all remained fairly constant for the North Dakota Council on the Arts, with the federal revenue decreasing slightly. The miscellaneous general revenue did have a significant increase due to the sale of commemorative state quarter sets during fiscal year 2007. Total revenues were \$667,631 for the year ended June 30, 2007 as compared to \$673,702 for the year ended June 30, 2006. The amount of federal revenue for the year ended June 30, 2006 was \$656,700 which decreased to \$572,300 for the year ended June 30, 2007. As the North Dakota Council on the Arts receives both federal and general fund appropriation to spend on their grants, their request for reimbursement from the NEA was greater in 2006 than 2007.

Total expenditures and transfers out for the North Dakota Council on the Arts were \$1,165,658 for the year ended June 30, 2007 as compared to \$1,009,524 for the prior year. The increase in total expenditures for fiscal year 2007 reflects primarily grants (which also account for approximately 66% of total expenditures in both years). All other expenditures remained fairly constant.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	June 30, 2007	June 30, 2006
<u>Revenues and Other Sources:</u>		
Federal Revenue	\$ 572,300	\$ 656,700
Miscellaneous General Revenue	77,256	1,163
Interest and Investment Earnings	17,289	7,500
General Government	736	720
Program Income	50	7,620
Total Revenues and Other Sources	\$ 667,631	\$ 673,702
<u>Expenditures and Other Uses:</u>		
Grants, Benefits, and Claims	\$ 784,654	\$ 662,532
Salaries and Benefits	232,760	216,935
Travel	29,005	25,289
Professional Development	24,621	24,887
Rentals/Leases	18,072	17,893
Fees – Professional Services	15,929	8,749
Supplies	24,693	2,593
Printing	11,890	3,252
Information Technology	10,745	15,736
Operating Fees and Services	6,062	6,117
Postage	5,975	4,117
Insurance	636	660
Repairs	615	766
Transfers Out		20,000
Total Expenditures and Other Uses	\$1,165,658	\$1,009,526

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Salaries and Benefits	\$ 455,466		\$ 455,466	\$ 449,694	\$ 5,772
Operating Expenses	227,986		227,986	208,531	19,455
Grants	1,476,257		1,476,257	1,362,542	113,715
Lewis and Clark Bicentennial	108,300		108,300	107,173	1,127
Totals	<u>\$ 2,268,009</u>		<u>\$ 2,268,009</u>	<u>\$ 2,127,940</u>	<u>\$ 140,069</u>
Expenditures by Source:					
General Fund	\$ 999,691		\$ 999,691	\$ 976,421	\$ 23,270
Other Funds	1,268,318		1,268,318	1,151,519	116,799
Totals	<u>\$ 2,268,009</u>		<u>\$ 2,268,009</u>	<u>\$ 2,127,940</u>	<u>\$ 140,069</u>

Expenditures Without Appropriations Of Specific Amounts:

The North Dakota Cultural Endowment fund was created by the 1979 Legislature and is authorized by NDCC 54-54-08.1. Only the interest earned on this fund may be spent. For the 2005-2007 biennium, \$12,500 was spent from this fund for the grants given to the Individual Artist Fellowships. Interest of \$34,742 from this fund was used to purchase state quarter commemorative sets to be sold. All revenue received from the sale of the quarter sets was deposited back into the Cultural Endowment fund.

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the North Dakota Council on the Arts' internal control as being the highest risk:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the processing of payroll.
- Controls surrounding the investments.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of the North Dakota Council on the Arts in a management letter dated June 30, 2008.

RECEIPTS RECONCILIATION

Finding 07-1

The Council on the Arts is not performing an independent reconciliation of receipts to deposits. We also noted the Council was not preparing receipts for any funds collected for the Cultural Endowment Fund. These collections included the sale of North Dakota commemorative quarter sets and Christmas ornaments.

The lack of receipts reconciliation weakens internal control since it would be possible for someone to take cash/checks after they have been receipted, but before the deposit is made, and not be discovered. Also, without any receipts, it is not possible to know if the quarter sets and ornament sales were properly deposited. The ND Council on the Arts was not aware of this needed control.

Audit Recommendation and Agency Response

Recommendation:

We recommend the North Dakota Council on the Arts ensure someone independent of handling cash and making the deposit reconcile the amount deposited to receipts. Also, all revenue collections (other than wire transfers) should be recorded on a receipt.

North Dakota Council on the Arts' Response:

The ND Council on the Arts agrees with the finding and will implement immediately the practice of requiring receipts for all funds received. The Executive Director will reconcile the deposited amounts to the receipt book.

REVIEW AND APPROVAL OF CORRECTING ENTRIES

Finding 07-2

The North Dakota Council on the Arts is not properly documenting their review and approval of correcting journal entries in the PeopleSoft general ledger.

An individual independent of preparation should review and approve all correcting entries after being posted to PeopleSoft to ensure they have been entered correctly. There was no documented review after correcting entries had been posted by the Office of Management and Budget. Without a proper review, errors or irregularities may go undetected.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Council on the Arts have someone independent of posting entries into the general ledger approve all entries. This approval must be done after the entry has been posted and is necessary until workflow is fully implemented for general ledger entries.

North Dakota Council on the Arts' Response:

The ND Council on the Arts agrees with this finding. The Executive Director or a designated staff member independent of staff posting entries to the general ledger will approve all entries after they are posted.

Finding 07-3

RECONCILIATION OF FEDERAL REVENUE

The North Dakota Council on the Arts is not reconciling revenue received from the federal government to revenue deposited on PeopleSoft.

The lack of reconciliation of federal revenue would make it possible for the individual responsible for requesting federal revenue to possibly divert a drawdown into an incorrect account and it would not be detected.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Council on the Arts have someone independent of requesting federal draws reconcile the amount received to the amount deposited on PeopleSoft.

North Dakota Council on the Arts' Response:

The ND Council on the Arts agrees with this finding. All federal government revenue will be reconciled with the actual deposits on PeopleSoft by the Executive Director or a designated staff member independent of the person making the request for funds.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested North Dakota Council on the Arts' compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Included In Our Audit Scope

- Proper use of the legally restricted Cultural Endowment Fund.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

Operations

This audit did not identify areas of North Dakota Council on the Arts' operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

Management Letter (Informal Recommendations)

June 30, 2008

Ms. Janine Webb
Executive Director
North Dakota Council on the Arts
1600 E. Century Avenue, Suite 6
Bismarck, ND 59503

Dear Ms. Webb:

We have performed an audit of the North Dakota Council on the Arts for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Council on the Arts' internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

PAYROLL

Informal Recommendation 07-1: We recommend that an individual without payroll access print off and approve the One-Time Payment query.

GENERAL

Informal Recommendation 07-2: We recommend the ND Council on the Arts establish and perform a fraud risk assessment on a recurring basis. We also recommend the ND Council on the Arts design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated.

Management of North Dakota Council on the Arts agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-3711 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Kristi Morlock
Auditor in-charge